SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 1221

JANE CROZIER, ROBERTA GIESECKE AND HARRIET M. ACKERT,

Petitioners,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY

BRIEF IN SUPPORT

I

Opinion of the Court Below

The Opinion of the Special Court, sitting as the District Court of the United States for the District of Maryland, was rendered on November 20, 1945, and appears on Record pages 1549-1607 and is reported in 63 F. Supp. 542 (Advance Sheets).

II

Jurisdiction

The essential facts relative to the jurisdiction of the Court are fully stated in the accompanying Petition for Certiorari (*supra*, page 7), and in the interest of brevity are not repeated here.

III

Statement of Case

This case originated as a proceeding under Chapter XV of the Bankruptcy Act for the approval and confirmation of a plan of adjustment entitled "Adjustment Plan of the Baltimore and Ohio Railroad Company dated September 20, 1944, as Modified." The Plan affected eight (8) classes of creditors of the Railroad, holding claims as of August 31, 1944, in the principal amount of $497,969,236. After hearings required by law, the Court made certain modifications in the Plan and rendered its Opinion under date of November 20, 1945. After an unavailing Motion for Reconsideration filed by these Petitioners (R. 1625), the Court entered its Decree approving the Plan on March 13, 1946 (R. 1936). Among the provisions of the Plan which were approved by the entry of said Decree was a provision which approved a Supplemental Indenture, supplementing the original Refunding Mortgage Indenture as modified by Supplemental Indenture dated January 1, 1940, all in accordance with the following provision of the Plan:

> "The Supplemental Indenture will also provide for the removal of any and all existing restrictions upon the extension, renewal or refunding of bonds of any issue or series, or any other debt now or hereafter oustanding or pledged, secured by lien senior to that of the Refunding Mortgage to the end that any such bonds or debt may be extended, renewed or refunded at any time or from time to time without the consent of the Refunding Bondholders."

Prior to the approval of this Plan and the Supplemental Indenture implementing it, Article Seven, Section 1 of the Mortgage Indenture, as amended, securing the Refunding Mortgage Bonds provided:

"There is hereby added after the second paragraph of Section 3 of Article Seven of the Refunding Mortgage a new paragraph as follows:

'Notwithstanding the foregoing provisions, the Railroad Company hereby expressly reserves the right to extend (on such terms and for such periods as the Railroad Company may from time to time determine) (a) any bonds or other indebtedness of any issue, all or any part of which was outstanding in the hands of the public on August 15, 1938, secured by a lien senior to that of the Refunding Mortgage and maturing prior to January 1, 1947, and (b) with the consent of holders of 66⅔% in principal amount of the Refunding Bonds at the time outstanding (excluding bonds pledged to secure other obligations of the Railroad Company and bonds in the treasury of the Railroad Company) any such senior bonds or indebtedness of any later maturity or maturities.' "

By virtue of the approval of the quoted portion of the Plan the Court authorized the removal of the restrictive covenant against the extension or renewal of any other debt of the company whether now existing or hereafter outstanding, secured by a lien superior to the Refunding Mortgage, without the consent of any Refunding Bondholders. It is this action of the Court below that is involved in this petition.

IV

Specification of Errors

1. The Court erred in finding that the Adjustment Plan, as modified and approved, is in the best interests of the holders of Refunding and General Mortgage Bonds, is fair and equitable to the holders of said bonds as an adjustment, affords due recognition to the rights of the holders

of such bonds and affords a fair consideration to them, and that said Adjustment Plan, as modified and approved, conforms to the law of the land regarding the participation of said class of creditors and the stockholders.

2. The Court erred in approving the provision of the Adjustment Plan for the removal of the restriction contained in Article VII, Section 3, of the Refunding Mortgage, as amended by Article Seven Sec. 1 of the Supplemental Indenture thereto, in that such provision is unfair and inequitable to the Refunding Bondholders; goes beyond the debt adjustment authorized by Chapter XV of the Bankruptcy Act; grants to the Railroad an unauthorized delegation of the Special Court's power to grant extensions without submitting the matter to the jurisdiction of the Court; grants to the Railroad a greater right of debt modification than is granted by Chapter XV; is violative of the law announced by the decisions in *Northern Pacific* v. *Boyd*, 228 U. S. 482, 57 L. Ed. 931; *Kansas City Terminal R. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 70 L. Ed. 1028; *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 84 L. Ed. 110, and kindred cases; and deprives the holders of Refunding Bonds of their property without due process of law and without due or just compensation in violation of the Fifth Amendment to the Constitution of the United States.

3. The Court erred in overruling Intervenors Crozier *et al.*, Point V (7) of their Objections and Intervening Petition (R.-120).

4. The Court erred in overruling Point 2 of Intervenors Crozier *et al.*, Motion for Reconsideration (R-1625).

5. The Court erred in finding that the Railroad's inability to meet its debts is reasonably expected to be temporary only, in approving the extension of the debt for period

from 30 to 50 years and finding thereby that the Adjustment Plan is not likely to be followed by need of further reorganization or adjustment, and in finding at the same time a necessity for removing the restrictions contained in Article VII, Section 3, of the Refunding Mortgage (PX 18) (R-961) as amended by Article Seven Sec. 1 of the Supplemental Mortgage (PX 19) (R-1105) thereto against further extensions than those called for by the Adjustment Plan.

6. The Court erred in its findings under Clause (3) of Section 725 of Chapter XV of the Bankruptcy Act in that its Opinion shows that in making such findings it was influenced by the extent of acceptances of such plan and the lack of opposition thereto; and that it was influenced by the fact that the Interstate Commerce Commission had authorized the modification of the securities as proposed by the Plan.

V

Argument

1

This Court in a long line of decisions commencing with the landmark decision of *Northern Pacific* v. *Boyd*, 228 U. S. 482, 57 L. Ed. 931, 33 S. Ct. 554, continuing through *Kansas City Terminal Railroad* v. *Central Union Trust Co.*, 271 U. S. 445, 70 L. Ed. 1028, and culminating in the relatively recent decisions of this Court in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 84 L. Ed. 110, 60 S. Ct. 1, and *Consolidated Rock Products* v. *DuBois*, 312 U. S. 510, 85 L. Ed. 982, 61 S. Ct. 675, has uniformly held that in any reorganization arrangement or plan enforced without the consent of the parties affected by it, the

vested rights of senior security holders cannot be reduced or infringed unless the junior security issues are eliminated or make appropriate substantial concessions to serve as consideration for any reduction in senior rights. Stated conversely, the rule is that any plan by which subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of other security holders, is unfair and inequitable and will not be judicially sanctioned.

This rule has become well known as the doctrine of absolute priority. It has been specifically applied to equity receiverships as well as to corporate bankruptcy proceedings under Section 77b and Chapter X, to municipal reorganizations under Chapter IX and to railroad bankruptcies under Section 77. It has been applied to both solvent and insolvent companies.

The words "fair and equitable" have in reality become words of art which require the application of the principles of the *Boyd* and parallel cases.

Chapter XV of the Bankruptcy Act has never been before this Court in a decided case, and consequently there is no authoritative decision of this Court determining whether Section 725(3) of said Chapter XV requires application of the principles of the *Boyd* case. On the face of it no reason is apparent why any different rule than the doctrine of strict priority should apply under Chapter XV of the Bankruptcy Act unless Congress in enacting it had otherwise expressly stated, which it did not.

Chapter XV became a part of the Bankruptcy Act on July 28, 1939 and expired by its own terms on July 31, 1940, (Pub. No. 242, 76 Cong. 393, 1st Session.) The McLaughlin Act, the present Chapter XV, was a re-enactment and varies in no respect here pertinent from the original Chapter XV.

The present Chapter XV expired, except as to pending proceedings, by its own terms on November 15, 1945.[5]

Congress in passing the original Chapter XV and the subsequent McLaughlin Act unquestionably intended to specifically incorporate therein the principles of the *Boyd* decision. This is made clear by specific statements to that effect in both the House and Senate Reports (H. R. No. 338, 76th Cong., 1st Session, page 3; S. R. No. 487, 76th Cong., 1st Session, page 7; H. R. No. 2177, 77th Cong., 2nd Session, page 5; S. R. No. 1617, 77th Cong., 2nd Session, pages 4 and 5).[6]

That the principles of the *Boyd* case were specifically incorporated in Chapter XV is the conclusion of Professor Gerdes in writing the chapter, "Bankruptcy and Corporate Reorganizations," in the *1942 Annual Survey of American Law* where at page 555 he discusses the precise question here under consideration, saying:

> "The requirement that the plan be 'fair and equitable' incorporates the absolute priority theory which prohibits recognition in the plan of any interest of junior creditors or stockholders having no equity in the assets of the debtor unless new consideration is paid by them."

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[5] A bill to revive Chapter XV has already passed the House without a dissenting vote and is now pending in the Senate, and another bill (S. 1253, 79th Cong., 2nd Session) which purports to adopt "the basic principle of Chapter XV procedure in authorizing reorganization without forfeiture of either bonds or stock" (S. R. No. 1170, 79th Cong., 2nd Session, page 145) has passed the Senate and is pending in the House. This latter bill would largely, if not entirely, supersede Section 77 proceedings and would become the permanent bankruptcy procedure for railroad reorganization.

[6] Colonel Anderson, who was Chief Counsel for the Baltimore & Ohio in connection with securing court approval of the 1938 Plan and who was active in securing the original passage of Chapter XV, stated at the time of the prior case that the words "fair and equitable" as used in the Act were understood by the Congressional Committees and by the Interstate Commerce Commission to incorporate the principles of the *Boyd* case.

Certain fundamental distinctions exist between a Section 77 railroad reorganization and a Chapter XV reorganization. Under Chapter XV the Interstate Commerce Commission does not pass on the basic legal requirement of fairness and equitableness. It conducts no poll to determine assenting shareholders, the plan having already originated with the management (the stockholders), and certain assents are required to have been obtained before the matter reaches the Commission. It is not until after the Plan has reached the Court and the final requisite number of security holders have consented that any judicial determination of the fairness and equitableness of the Plan is required. Under such a procedure, coupled with the fact that any such Plan is of necessity a management plan (and presumptively is in the interest of stockholders), it is inconceivable that a test of fairness and equitableness less strict than that required in all other forms of bankruptcy and equity proceedings could possibly be contemplated.

It is submitted that the rule of absolute priority is fully applicable to Chapter XV proceedings.

2

The railroad's covenant with the Refunding Bondholders against the extension or renewal of prior mortgages is a fixed property right. It is entirely surrendered under the present Plan. The strategic position of the Refunding Bondholders to in reality ultimately become prior lien bondholders is greatly weakened thereby, if not in fact completely lost. That this is a valuable right, protection against the loss of which is guaranteed by the *Boyd* case, is abundantly clear from the language of this Court in the somewhat similar situation ruled upon in the *Consolidated Rocks Products* case, *supra,* where at *page 528* in the Official Reports, this Court, after stating that the "relative priorities" had been maintained, went on to say:

> "But the bondholders have not been made whole. They have received an inferior grade of security, inferior in the sense that the interest rate has been reduced. A contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of preferred stock, *and their former strategic position has been weakened. Those lost rights are of value.* Full compensatory provisions must be made for the entire bundle of rights which the creditors surrender." (Emphasis supplied.)

In the case at bar the opinion of the Court below does not suggest that the Refunding Bondholders have received any compensation for this valuable right which they are required to surrender. While admitting that the deprivation of this contractual right "is necessarily inconsistent with these covenants in the original Refunding * * * Indentures," the Court below disposed of the point by the weak statement that, "But as we have previously pointed out, we consider the refunding provisions of the present Plan to be of real importance to the Plan as a whole and really in the interests of all classes, including the Refundings and Convertibles, because it is quite possible that this privilege of refunding may take advantage of even existing lower interest rates with consequent reduction of interest charges." The Court completely failed to consider whether there was any adequate compensation for surrender of this right by the test of the *Boyd* case, and, in fact, neither that case nor any of the parallel cases following it are mentioned in the lengthy Opinion of the Court below. If it should be thought that while the Court below did not expressly hold that said principles were applicable it was in fact trying to apply those principles, then its conception of compensation for the surrendered rights, as gleaned from the foregoing quotation, is wholly inadequate to support the conclusion reached.

In the first place, the Court has unquestionably misconceived the objection of these Petitioners (Intervenors below). We did not object to a *refunding* to permit the Railroad to secure a lower interest rate so long as such refunding does not violate the contractual right of these holders against an extension or renewal of such prior lien bonds *beyond the new maturities thereof as provided for in the Plan.* The only recognition (if it may be called such) in the opinion of this point is a short paragraph on page 568 of the Opinion. There the Court says the indentures securing both the Refundings and the Convertibles contain prohibitions against the Railroad making any "new" mortgages to take precedence over them. We know of no such provision in the Refunding Mortgage—it contains, instead, the covenant against extension or renewal, the removal of which by the Plan we oppose. On the other hand, the Convertibles Indenture does contain a prohibition against any new mortgages to take precedence over them, but does not contain a restriction against extension or renewal of existing prior mortgages. Obviously the Court was confused and overruled our objection without understanding it. And strangely enough, we do not find in the Plan any provision calling for the removal from the Convertibles Indenture of the prohibition against "new" mortgages to take precedence over them. Surely this is confusion confounded, and not indicative of a ruling upon our objection based upon an understanding of the issues. No reason is suggested why, if the prior lien bonds could be refunded at all, they could not be refunded with the same maturities to which they are extended under the Plan, thus gaining the advantage of a lower interest rate without violating the covenant against *extension* or *renewal.* This Court will undoubtedly take judicial notice of the fact that in refunding operations the shorter the maturity, the lower rate of interest that can be obtained. As the prior lien bonds as extended by the

Plan will not mature for many years, it seems perfectly self evident that any refunding beneficial in reducing interest could be effected without further extending or renewing the new bonds as set up under the Plan.

In the second place, it is error for the Court below to take the position that merely because *refunding* provisions are of importance to the Plan as a whole (which, of course, means retaining the stockholders' interest intact), such fact affords compensation for the taking away from the Refunding Bondholders the covenant against *extensions* or *renewals.* Certainly, the mere fact that if a plan is not adopted a more drastic reorganization will result does not constitute compensation. Even in a more drastic reorganization (such as under Section 77) the Refunding Bondholders' right to complete priority over the stockholders would be guaranteed. There would be no loss to them if such an eventuality developed. Moreover, as this Court said in the *Los Angeles Lumber Products* case, the avoidance of liquidation is not consideration satisfying the absolute priorities rule. That a more drastic reorganization would result, in the event of the failure of this Plan, is directly contrary to the express statutory finding which the Court below was required to make and did make before approving this Plan, namely, that the Railroad is not in need of a Section 77 reorganization.

The nearest the Court below comes to actually finding any consideration moving to the Bondholders is at 63 F. Supp.; S. C. 561, when it states:

> "By the plan each of these classes (Refundings included) is required to make certain concessions or, if you please, sacrifices in the recapitalization. It is clear, we think, that the aggregate of the respective sacrifices to the plan as a whole *greatly improves the position of the Railroad* and adds to the prospect of its long continued prosperity as a going concern. In

this bettered position of the entity each of the affected classes participates and is itself bettered *at least in public estimation* as reflected in Moody's Rate Manual." (Emphasis and parenthetical words supplied.)

Lastly, the Court below suggests that the saving in interest rates that might result from refunding is in the interest of all classes. This is indeed a specious argument. If interest rates were reduced, the obvious result would be increased net earnings. The bondholders' ultimate claim upon those earnings are fixed and will not be increased by the prosperity of the road whether that prosperity results from better business conditions, decreased operating costs, or savings in debt charges. The real beneficiaries of any reduced interest are the stockholders, not the bondholders. In other words, this statement of the Court below accentuates the fact that the only real advantage that can come from this provision is the possible increased earnings which would, at the expense of the Refunding Bondholders, further line the pockets of the stockholders, who give up absolutely nothing under the Plan and whose rights are in no wise affected by it. Far from being a consideration passing to the Refunding Bondholders, the very argument which the Court below makes shows that the consideration passes to the stockholders and that can be no basis for depriving the Refunding Bondholders of this valuable covenant and is violative of the principles of the *Boyd* case.

3

The original Refunding Mortgage catagorically prohibits any *extension* or *renewal* of any prior lien bonds. The 1938 Plan modified this provision by permitting such renewal or extension with the consent of the holders of two-thirds (⅔) of the bonds. For the partial surrender and modification of this right by the 1938 Plan it gave

the Refunding Bonds a conversion privilege not previously enjoyed by them. The present Plan eliminates the two-thirds (⅔) consent requirement and allows the unrestricted extension or renewal of any prior mortgage bonds without any action or consent by the Refunding Bondholders and, in fact, over their express objection. The Refunding Bondholders under the present Plan receive nothing for this express right that has been taken away from them by the present Plan. Chapter XV of the Bankruptcy Act, under which this proceeding is brought, expressly requires the Court to find that the Railroad's inability to meet its debts is reasonably expected to be temporary only. The Court is further required to expressly find that the present Plan is not likely to be followed by the insolvency of the Petitioner or by need of financial reorganization or adjustment. Therefore, the Court in order to approve this Plan must and did find that the present situation in which the Railroad finds itself is temporary only and that the new scheme of extended maturities can be met at their respective due dates. This being true, it follows that the Court must find that the prior mortgage bonds can be paid at their maturity as extended under this Plan. Therefore, there would be no necessity for extension or renewal of said bonds as so extended by this Plan, and there is, therefore, no necessity for eliminating and taking away from Refunding Bondholders the presently existing provisions prohibiting such extension or renewal of prior mortgage bonds except upon the consent of the holders of two-thirds (⅔) of the Refunding Bonds. To hold, as the Court below did, that such provision is fair and equitable is wholly inconsistent with the required findings under Chapter XV of the Bankruptcy Act that the Petitioner's present position is temporary only and that it will not need further financial reorganization or adjustment, which finding the Court below actually made. This is particularly evident

when notice is taken of the fact that the provision of the Plan annihilating the covenant against extension will not be of any actual effect until forty (40) years from now. Until then, the bonds do not mature. So the Court is approving a provision to take effect forty (40) years later, while finding now that the present long-range Plan is not likely to be followed by need of financial adjustment.

A comparison of the present Plan with the 1938 Plan well illustrates how unnecessary is this provision. Under the 1938 Plan the original provision was modified so that a debt maturing before January 1, 1947, could be extended, with the consent of the holders of 66⅔% in principal amount of the Refunding Bonds outstanding. This was deemed adequate in 1939 at a time when the company had large maturities coming up in 1944, 1948, 1951, etc., when the railroad's debt was $110,000,000 larger, the maturities much nearer and their ability to pay far less. Can it be said reasonably that the Petitioner needs greater concessions from the Refundings than were extracted under the 1938 Plan? Can it be said as a matter of law that such a provision of the Plan is fair and equitable when stockholders are required to make no concessions whatsoever?

4

One of the principal inducements made to the holders of the Refunding Bonds and the theory behind the original issuance thereof was the representation and assurance that by 1951 they would have for all practical purposes a first lien. The 1938 Plan whittled away a part of that assurance by reducing the number of holders of principal amount of Refunding Bonds that must consent to an extension of prior liens. Any extension has the effect of continuing the subordinate position of the Refundings for a greater period than was originally contemplated. The

present Plan as approved by the Court below has entirely eliminated this assurance of ultimately having a prior mortgage position because now the railroad company can extend into perpetuity its prior liens not only without the consent of the Refundings but against their active opposition, so that in fact the Refundings may never become a first mortgage and undoubtedly will be left as a second mortgage on properties of the railroad. This is being done without any concessions whatever from the stockholders.

A glance at Petitioners' Exhibit 89 (R. 2013) will show that by the payment of two relatively small issues the Refunding Bonds would constitute a first lien on a greater trackage than the other prior lien bonds now have. As a matter of fact, payment of the $37,000,000 P. L. E. and W. Va. bonds would give the Refundings a first lien on the very heart of the Baltimore & Ohio System, as the present First Mortgage issues are only on the eastern lines and the Chicago extension—two disconnected segments which could not be satisfactorily operated without the mileage covered by the P. L. E. and W. Va. Mortgage. Then, if in addition the $37,000,000 of S. W. Division bonds were paid, the Refundings would have a first lien on more system mileage than the First Mortgage issues, including the vital center section. Absent the Plan, the P. L. E. and W. Va. bonds are due in 1951 and the S. W. Division bonds are due in 1950, and would have to be paid then. The Plan extends both issues to 1980—a very great sacrifice the Refundings make in that particular alone—and yet the Court would approve the provision objected to and let the Road further extend those issues in 1980 without either approval of the Court or the Refunding Bondholders. The very real value of the covenant against extension or renewal is thus readily apparent.

With the restrictive provision contained in the mortgage the Refunding Bondholders could confidently look forward to the maintenance of their present lien position and with the prospect that in 1980 there would be a distinct improvement thereof in accordance with the contemplation of the original covenant of the Refunding Mortgage. By the Plan they are deprived of their present position and instead of being able to look forward to an improvement of that position, they are now faced with the practical certainty of the continuance of a subordinate, and even a further subordiated, position for all future time.

The drastic curtailment of the Refunding Bondholders' rights by the complete elimination of the restrictive covenant can further be recognized by another comparison with the 1938 Plan. While that Plan reduced the requirement for extension or renewal from unanimous consent to consent by holders of two-thirds (⅔) of the Refunding Bonds, such a provision could in part be justified by the practicalities of the situation, for it is obviously difficult to secure unanimous consent from a large group of bondholders. It usually happens that some bondholders become completely lost and cannot be located to secure their consent even though they are not active opponents. Furthermore, under the modern concept of bankruptcy legislation it is usual and customary that the consent of two-thirds (⅔) can control minorities. Under Chapter XV a mortgage could be extended or renewed with such percentage of consent. Therefore, it would not seem entirely unreasonable to reduce the percentage required under the contract to a percentage comparable with the number that would have to consent to secure court approval. However, when the court approves a plan which completely eliminates any requirement for the consent of any bondholders and allows extension and renewal without any consent and over active opposition, the court is in effect delegating its powers under

Chapter XV or any act then in force. Congress obviously did not intend to let the court in effect approve a plan granting long extensions and then add: "If these aren't long enough, do it yourself next time and don't come back here." The Refunding Bondholders at this time are compelled for all time in the future to accept the action of the management (which, of course, in reality is the stockholders) without court approval to continually keep their rights submerged. Such action of the stockholders can be exercised as their whim may dictate and whether or not any necessity exists and without subjecting their action to the scrutiny or approval of any court.

The provision approved in the 1938 Plan, while not entirely free from question as to validity, certainly represents the outside limit to which the court in a Chapter XV proceeding can go in affecting the rights of the Refunding Bondholders. Moreover, it must be remembered that as the consideration for this concession in the 1938 Plan the Refunding Bondholders did receive a conversion privilege, something which they previously did not have. It might be noted that no similar concession was made or new right given under the 1938 Plan to any prior-lien bondholders, as no rights were being absolutely taken away from them; they were merely having their rights deferred rather than eliminated. The concession to the Refundings was unquestionably given as compensation for the taking away of a portion of their covenant against extension or renewal. Under the present plan the entire right is taken away. No comparable consideration is given.

5

This objected to provisions of the Plan as approved by the Court below deprives the Refunding Bondholders of their property without due process of law and violates the provisions of the Fifth Amendment to the Constitution of

the United States, as there is no consideration whatever passing to such bondholders for the compelled surrender of the right. It is perfectly clear that a valuable right has been taken away from the Refunding Bondholders. An over-all examination of the Plan clearly indicates that no objective standard was used by the Railroad in preparing the Plan, or by the Court below in approving it, to determine the relative value of the different mortgages. As a practical matter, the Refunding Mortgage, as above shown, has been relegated permanently to a second-lien position (without any reference to Exhibit 89, which shows how easily it might become a superior mortgage to the so-called First Mortgage Bonds and without any reference to the fact that upon discharge of all prior liens it would become a first lien upon the entire system). No concession has been extracted from the stockholders. These matters all point to a flagrant violation of the Constitutional Amendment and a deprivation of the Refunding Bondholders' property without due proces of law and without just compensation.

6

The foregoing argument has assumed that the Refunding Bondholders have received no consideration whatever for the surrender of the right that has been herein discussed. We think that what we have said sufficiently makes this clear. Admittedly there is no provision for compensation such as was contained in the 1938 Plan (the granting of a conversion privilege). The Opinion of the lower Court has not pointed to any compensation or consideration moving to the Refunding Bonds, although as discussed under 2 above, the Court suggested that it was to the interest of the Plan as a whole and the Refunding Bondholders, but without a showing of any actual consideration. Such an unsupported conclusion not only begs the question, but fails

to answer it for the reasons we have discussed under 2 above. It is also suggested in the Opinion of the Court below that the elimination of the covenant is necessary for "flexibility." Apparently the argument is that the railroad needs assurance against foreclosure of prior liens at maturity. However, that argument is inconsistent with the finding that the Plan creates a sound financial structure for the railroad and will not be followed by further reorganization or adjustment. Furthermore, if in the future the Refunding Bonds were actually faced with a probability that prior liens would be foreclosed and their security wiped out, can it be reasonably argued or thought that any difficulty would be encountered in securing the approval of the holders of two-thirds (⅔) of the then outstanding bonds? Their self-interest would dictate rapid and active cooperation under such circumstances. There is no justification for capriciously completely eliminating at this time their right to disapprove extensions or renewals which may be conjured up in the future solely by the stockholders acting through the management in their own self interest.

The above are the only matters which the Court below even remotely suggested constituted consideration. However, the Railroad in its brief below asserted that such matters as the creation of a sinking fund, a capital fund, and some similar provisions of the Plan would constitute consideration. Such claims are of so little merit that they hardly need be answered. Suffice it to say that the inclusion in the Plan or the implementing mortgages of features normally common in such situations do not raise such features to the dignity of compensation. This Court made that entirely clear in its opinion in *Group of Institutional Investors* v. *C. M. St. P. & P. Railroad*, 318 U. S. 523, l. c. 571, 87 L. Ed. 960, l. c. 1010, where it was said:

"Certainly we cannot say that the inclusion in the new securities to be received by the General Mortgage Bonds of features normally common to them are adequate compensation for the lost seniority," and at pages 569/570 where it was again emphasized that creditors "must receive, in addition, compenation for the senior rights which they are to surrender * * * unless this principle is respected, there will be serious invasion of the rights of senior claimants to the benefit of junior interest. The property of one group will be subtly appropriated to pay the claims of another while lip service is rendered to the principles of priorities."

7

Our argument so far has proceeded upon the theory that under Chapter XV a radical change in the rights of security holders is permissible so long as the absolute priority doctrine is scrupulously enforced. However, it also seems clear that no deprivation of a fixed or vested right was even within the Congressional contemplation of Chapter XV.[7]

The very distinctions which the Congress made between Chapter XV proceedings and Section 77 proceedings, particularly the requirement of Chapter XV that the railroad be not in need of a Section 77 reorganization, are suggestive of an underlying fundamental distinction between the type of relief that can be granted under the two acts. Sec-

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[7] See H. R. Hearings on H. R. No. 3704 and H. R. No. 5704, 76th Con., 1st Session, page 83. Mr. Harry Haggerty, Vice-President and Treasurer in Charge of Investments of the Metropolitan Life Insurance Company, testified before the Senate Committee on Interstate Commerce on November 7, 1945 in connection with the hearings on Senate Bill 1253 as follows: "However, the lawyers of the Delaware and Hudson maintain that under the McLaughlin Act (Chapter XV) you could do just one thing, extend maturity, that you could do nothing else. Now if that is true—there is a difference of opinion among lawyers—there should be some way of giving greater latitude in the way of permitting comprehensive debt adjustment." Hearings before Committee on Interstate Commerce, U. S Senate, 1st Session, on Senate 1253, page 29.

tion 77 grants complete latitude and permits the complete annihilation of the interests of security holders found to have no equity in the company. Chapter XV, on the other hand, provides for *adjustments,* deferments of rights but not the annihilation of them.

Chapter XV contemplates a solvent railroad.[8] Obviously a solvent railroad does not need a radical reorganization in the sense that any class of security holders need be eliminated. It would seem to follow that it is highly questionable whether a solvent railroad should ever be permitted to extract any vested right from a creditor. Under the absolute priority doctrine this could not be done unless the stock made a real and valuable concession, and as we have seen, Chapter XV contemplates leaving the stock interests untouched. Therefore, it seems clear that basically no vested right could be taken away from any class of creditors under Chapter XV as there is no practicable way of obtaining a real and valuable concession from the stock when it is left untouched.[9] Furtherfore, if the annihilation of substantial rights can be forced upon creditors in a Chapter XV proceeding (even if the absolute priorities rule is enforced), it is then difficult to see how Chapter XV substantially differs from Section 77. It would be mere duplication and surplusage. Such intention cannot be imputed to Congress.

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[8] 1942 Annual Survey of American Law (New York University School of Law), page 554.

[9] About the only practical way of receiving compensation would be the means actually used by the Baltimore & Ohio under their 1938 Plan when the stockholders gave the Refunding Bondholders a conversion privilege as compensation for the change that was then made in the same indenture provision, the complete elimination of which is now objected to. While this consideration momentarily left the stock untouched, it did provide the means whereby the stock could be diluted and thereby affect the stock interest and at the same time afforded to Refunding Bondholders a real consideration for what they were required to give up inasmuch as it afforded an opportunity to share in future prosperity of the company.

Apparently even the lower Court feels that Chapter XV limits the "adjustments" allowed to those which do not annihilate creditors' rights. As proof of this, the opinion shows the court, in every instance when discussing the features of the Plan, states repeatedly that the Plan only postpones creditors' rights. At 63 F. Supp. i. c. 547/8 the Court says:

> "The principal features of the adjustment plan now submitted * * * consist in the extensions of the maturity of five of its large bond issues and in providing that a certain portion of fixed interest on some of the issues be made payable only contingently upon earnings sufficient therefor, but to be fully cumulative until finally fully paid. The plan contemplates that the security for existing obligations of the Company remain unchanged."

At l. c. 548/9, referring to other "carefully worded" provisions of the Plan, the Court has either overlooked or carefully avoided the provision of the Plan here under discussion, which is a provision which contemplates changing and *diminishing* the security for the Refunding Bonds. Nor is the provision even touched upon under the part of the Opinion labeled, "Consideration of Fairness of the Plan." Yet, on page 551 the Court says that a study of the main features of the Plan leads the Court to the conclusion it is fair and equitable. White not examining or referring to the provision we here challenge, the Court at l. c. 552 again asserts the Plan does not "impair any of the present security for the several affected issues respectively. It merely *postpones* the maturities * * * and possibly some of the interest thereon."

At l. c. 561 the Court concludes the Plan conforms to Legal standards because "There is no reduction of the amount of contractual obligation of the B. & O. for either principal or interest, and no impairment of the security

therefor. The only change is postponement of maturity of principal, and the time of payment of interest made contingent upon earnings, but fully cumulative until finally paid." Also at l. c. 561 the Court infers that all the Refunding Bonds *yield* is a portion of their fixed and secured interest to contingent interest, the latter payable, however, prior to unsecured contingent interest.

Creditors, of course, make concessions under Chapter XV, but the concessions that have been generally recognized[10] are only those which postpone rights and do not obliterate them. Mere postponement is simply equivalent to a moratorium and is not objectionable constitutionally or otherwise without stockholders' concessions.[11]

The Interstate Commerce Commission, in a letter from its Chairman to Congressman Sumners (reported in H. R. Hearings on H. R. 3704 and H. R. 5704, 76th Cong., 1st Sess., at page 83) expressed their opinion that *deferment* plans are the only type a court can approve under Chapter XV. And in PX 3, herein (Report of the I. C. C. on the plan here—*R. 49*), the decision of the Interstate Commerce Commission contains this statement:

> "We are of the opinion that the plan would be improved if the contingent interest were not to be fully cumulative, but any plan containing provisions that would call for less than all the interest payments prescribed by the original terms of the bonds would not be consistent with an adjustment of this character * * *."

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[10] All of the plans that were approved under prior Chapter XV with the exception of the Baltimore & Ohio scrupulously avoided deprivation of contractual rights. They involved in the main mere extension of maturities (often with partial payments on account) and sometimes, similar to the Baltimore & Ohio, made part of the interest contingent but fully cumulative.

[11] *Home Bldg. & Loan Association* v. *Blaisdell*, 290 U. S. 398, 78 L. Ed. 413, 54 S. Ct. 231, 88 A. L. R. 1481.

One of the injunctions placed upon the Court below by Chapter XV is that the Court shall make its review and findings independently of the percentages of acceptances by security holders or lack of opposition thereto. The Court below, although giving lip service to this injunction, was obviously influenced in its thinking both by the apparently large number of acceptances and the lack of sizeable opposition. At *63 F. Supp., l. c. 553,* the Court said:

> "It is relevant to note how largely and widely the plan has been approved by the security holders of all affected classes. The holders of over 81% of the aggregate principal of all affected securities have affirmatively voted assent to the plan. Less than 1% have affirmatively dissented. Of the whole number of individual holders (less than 80,000), 39,738 have voted for the plan and only 103 against it, a percentage of over 99% for the plan and less than one-third of 1% against the plan, of those voting on it.[12] The percentages of those assents to the plan by holders of the several affected classes range from 86% to over 67%, excluding the R. F. C. as holder of the securities pledged as collateral for its loan. It has fully assented to the plan. The only intervenors in this case as objectors to the plan are listed in the margin.[10]"

Footnote 10 just referred to is as follows:

> "There are only a few intervenors in this case who oppose the plan either in toto, or in the alternative

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[12] It is interesting to note that even in thus stating the facts, the Court below emphasized the percentage in principal amount that had accepted and the principal amount that had *actively* dissented. It is of more than passing interest to note that these cited statistics affirmatively show that *less than one half of all the B. & O. bondholders as individuals* (as distinguished from principal amounts held) actually consented to the Plan. It is also a well known fact that most non voters are actual dissenters who merely lack the inclination, time or money to become active objectors in a huge reorganization case.

suggest modification. They are (1) George H. Phillips, the holder of an unspecified number of Convertible Bonds; (2) Jane Crozier, Roberta Giesecke and Harriet M. Ackert, holders of $5,000 Refunding 5's due 1996, and $1500 1st. Mtge. 5's due 1948; (3) Alfred M. Darlow, a former employe of the B and O whose petition for intervention states (without other proof) that he is the holder of $37,000 par value of various issues of the 1st. Mtge. Bonds, and Refunding 5's; (4) Charles M. Mervin, the holder of an unspecified number of Refundings and (5) Randolph Phillips, the holder of one-third interest in $100,000 par value of Convertibles. None was represented or participated in the hearing except Randolph Phillips (pro se) and Crozier, Giesecke and Ackert, who were represented by counsel. The latter did not oppose the plan as a whole but do suggest certain modifications which will be later noticed."

Lack of opposition is again referred to by the Court in its Footnote 21 at *63 F. Supp., l. c. 562.*

Footnote 27 on page 565 probably goes to the extreme in showing the influence on the Court of these factors which, by specific injunction of the Act, are not to be considered. That footnote reads as follows:

"Petitioner's Exhibits Nos. 101, 102. Counsel for the Petitioners has filed with its brief a list of about 150 banks, insurance companies and other institutions holder over $10,000 par value of the Convertibles which have affirmatively assented to the plan. This was compiled from petitioner's Ex. 100, which includes all the written assents to the plan. It is said that many of the Convertibles are held by individuals in the European war zone and could not be reached for assents to the plan."

It can be seen from the quoted footnote that the Court even attempts to volunteer an answer as to why more of the Convertible Bondholders had not assented than did in fact.

These later footnotes are included without even giving lip service to the injunction of the Act and on the contrary have been inserted in support of matters in the text of the Opinion. These particular intervenors were referred to as "two small bondholders" (63 F. Supp., l. c. 569).[13]

At 63 F. Supp. l. c. 562 the Court observes that as to the "Refunding Bonds, there is no active opposition to the Plan as a whole or contention that it is unfair to them" and in footnotes 21 and 22 specifically notes the principal *amount* of bonds making objection. The Court also, at the same page of the Opinion, in discussing the fairness of the Plan to the several classes of creditors leans almost entirely upon the report of the Interstate Commerce Commission, saying that it "deals in much detail with the several adjustments made in the several bond issues. We think it unnecessary to repeat here what has there been carefully outlined."

At 63 F. Supp. l. c. 565 the Court notes that most "of the few intervenors" propose modifications. At l. c. 569, while considering other proposals advanced to make the Plan fair and equitable, the Court states such a Plan will entail some collision between "details" of existing indentures and their revision under the Plan, and defers to the report of the Interstate Commerce Commission.

These instances disclose only too clearly how the Court has been influenced by the number of assents, the lack of opposition, and the report of the Interstate Commerce

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[13] While none of the actual proceedings at the hearings before the Court have been brought up by these Petitioners for the reason that it is not essential to a disposition of the issue here presented, it is our understanding that the entire record has been brought up by another applicant for certiorari and by the railroad, and in this Court's perusal thereof there will undoubtedly appear many instances of statements made from the bench which will throw further light upon the general attitude of the Court toward any opposition to any feature of the plan and the tremendous impression upon the Court made by the assents.

Commission, which Commission under Chapter XV is not called upon, and did not, pass upon the fairness or equitableness of the Plan. This is not the independent consideration of that point which Congress intended the only arbiter thereof (the Court) should exercise.

The error into which the Court below fell in giving excessive and improper weight to the factors of the number of acceptances and the lack of opposition is one that was easily foreseeable at the time of the adoption of the Act. Chairman Eastman of the Interstate Commerce Commission suggested that consideration of any plan by both the Commission and the court would inevitably be affected by the fact that much time and money had already been spent on the plan before its submission to the Commission or the court and that it had at that time already been accepted by a substantial number of the creditors (See Hearings of Senate Committee on Interstate Commerce on H. R. No. 5407, 76th Cong., 1st Session (1939) 62). It was undoubtedly this feature as well as the necessity of meeting the fair and equitable standard of the *Boyd* case that prompted Congress to include in Chapter XV the statutory language referred to. One writer [14] has characterized the inclusion of this provision as an "attitude of piety" and has intimated that this "pious wish" can hardly be achieved. It certainly cannot be achieved unless courts are rigorous in the enforcement of this clearly expressed provision.

That the court should be rigorous in the enforcement of this provision is clear, not alone from the wording of the Act, but from the repeated pronouncements of this Court. In the *Los Angeles Lumber Products* case, *supra,* this Court in unequivocable language pointed out that courts of bank-

[14] Hubert L. Will in the University of Chicago Law Review, February, 1940, page 211.

ruptcy are not relieved of their statutory duty to appraise the fairness and equitableness of a reorganization plan by the fact that even an overwhelming majority of creditors had accepted it. This same principle was later re-announced in the *Consolidated Rock Products* case and the *Milwaukee* case, *supra*, and in *Kelley* v. *Everglades Drainage District*, 319 U. S. 415, 63 S. Ct. 1141, 87 L. Ed. 1485, where this Court in granting certiorari and summarily remanding the case to the District Court without argument, said (l. c. 418),

> "The fact that only a very small minority of creditors have objected to the plan does not relieve the courts of the duty of appraising its fairness * * * (l. c. 419) the fact that the vast majority of security holders may have approved a plan is not the test of whether that plan satisfies the statutory standard. The former is not a substitute for the latter. They are independent." [15]

Unless the Courts are constantly vigilant and strictly enforce this principle which has the unqualified backing of the Congress and this Court, it will soon deteriorate into a mere idle phrase that retains its position in the literature of the law but not in its application. It should be particularly zealously guarded in a case of this kind where the plan has its entire conception in the management (the stockholders) and has wide acceptance before the question of fairness and equitableness is even in position to be raised and passed upon by a court.

While we feel that the Court below failed to comprehend the particular issue presented by these Petitioners, we feel that their failure so to do was largely a result of their inclina-

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[15] For another instance where this Court used identical language to that last quoted, see *American United Mutual Life Insurance Co.* v. *Avon Park*, 311 U. S. 138, l. c. 148, 61 S. Ct. 157, l. c. 136, 85 L. Ed. 91, l. c. 97, 44 Am. Br. (NS 269).

tion to dispose of many questions raised solely on the basis that the challenged provision had presumably been accepted by an overwhelming number of security holders and no one appeared in opposition except "two small bondholders"; that lip service to the rule of examining the plan independently did not in fact prevent a failure of the Court to realize the real issues embodied in this objection, so that the fundamental rights of the Refunding Bondholders were sacrificed upon the altar of expediency by the decision of the Court below.

It is respectfully submitted that the Writ of Certiorari should be issued.

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